

HOUSE FINANCE COMMITTEE BRIEFING

February 6, 2019

Finance Team

Presentation Overview

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- Introduction to the Finance Committee
- Overview of General Fund Revenue Sources
 - ▣ Personal Income Tax
 - ▣ Corporate Income & Franchise Tax
 - ▣ Sales Tax
 - ▣ Local Revenues

INTRODUCTION TO THE FINANCE COMMITTEE

Trina Griffin
Legislative Analysis Division

Finance Committee Staff

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Legislative Analysis Division 200 LOB; 733-2578

- Cindy Avrette
- Trina Griffin
- Greg Roney
- Nick Giddings
- Melissa Zbikowski

Legislative Drafting Division 401 LOB; 733-6660

- Dan Ettefagh

Fiscal Research Division 203 and 206 LOB; 733-4910

- Rodney Bizzell
- Jonathan Tart
- Denise Canada
- Barry Boardman
- Brian Slivka
- Emma Turner

Bills that must be referred to Finance

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House Rule 38

- ☐ Raises revenue
- ☐ Reduces revenue
- ☐ Levies a tax
- ☐ Authorizes levy of tax, assessment, or fee
- ☐ Authorizes issuance of bonds

Senate Rule 42

- ☐ Levying taxes
- ☐ In any manner affects taxing power of State or its subdivisions
- ☐ Imposing or raising fees or other revenues payable to the State, agencies, licensing boards, or any of its subdivisions
- ☐ Providing for bond issues

Bills NOT required to go to Finance

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- Civil penalties, criminal fines, forfeitures
- Relating to fees charged by a nongovernmental entity



Subcommittees

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□ Occupancy Tax

- ▣ In existence for over 20 years
- ▣ Looks for adherence to “Guidelines”
 - Rate – 6% max combined county and city rate
 - Use – 2/3 promotion; 1/3 tourist-related expenditures
 - Administration – Tourism Development Authority



□ Annexation/Deannexation

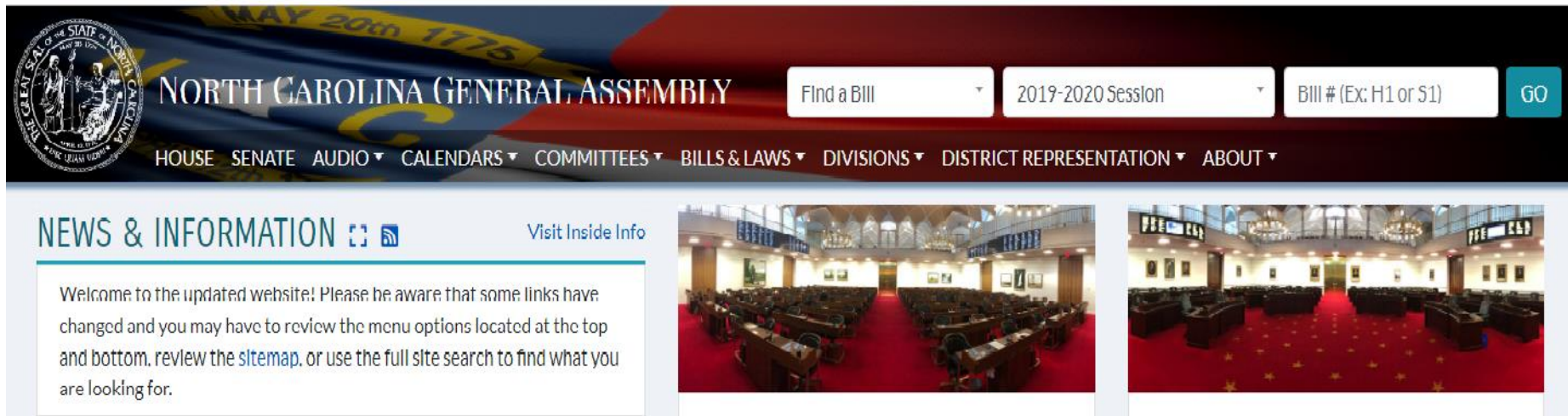
- ▣ Established in 2013
- ▣ Historically allowed under “Guidelines” for one of the following reasons:
 - Agreement of interested parties
 - Error correction
 - Changed circumstances




Resources

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- NCGA website
 - [Committee Website](#)
 - [Summaries of Substantive Legislation](#)



The screenshot displays the official website of the North Carolina General Assembly. The header features the state seal on the left, the text "NORTH CAROLINA GENERAL ASSEMBLY" in the center, and search and session selection tools on the right. A navigation bar below the header lists various sections. A "NEWS & INFORMATION" section is visible on the left, containing a welcome message. Two photographs of the legislative chamber are shown on the right.

 MAY 20th 1775
NORTH CAROLINA GENERAL ASSEMBLY



Find a Bill ▾ 2019-2020 Session ▾ Bill # (Ex: H1 or S1) **GO**

HOUSE SENATE AUDIO ▾ CALENDARS ▾ COMMITTEES ▾ BILLS & LAWS ▾ DIVISIONS ▾ DISTRICT REPRESENTATION ▾ ABOUT ▾

NEWS & INFORMATION

[Visit Inside Info](#)

Welcome to the updated website! Please be aware that some links have changed and you may have to review the menu options located at the top and bottom, review the [sitemap](#), or use the full site search to find what you are looking for.

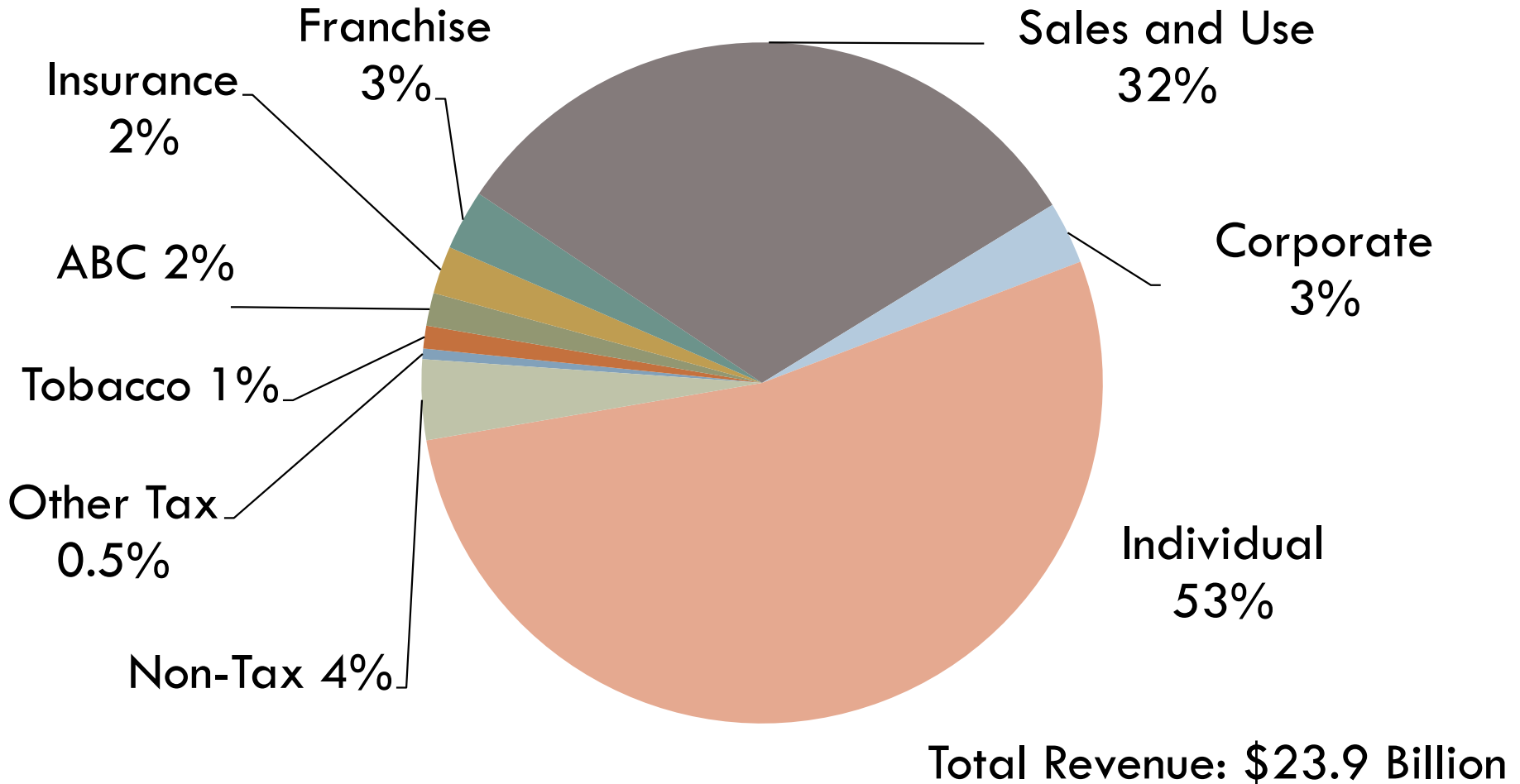


OVERVIEW OF GENERAL FUND REVENUE SOURCES

Emma Turner
Fiscal Research Division

General Fund Revenue by Source

FY 2018-19



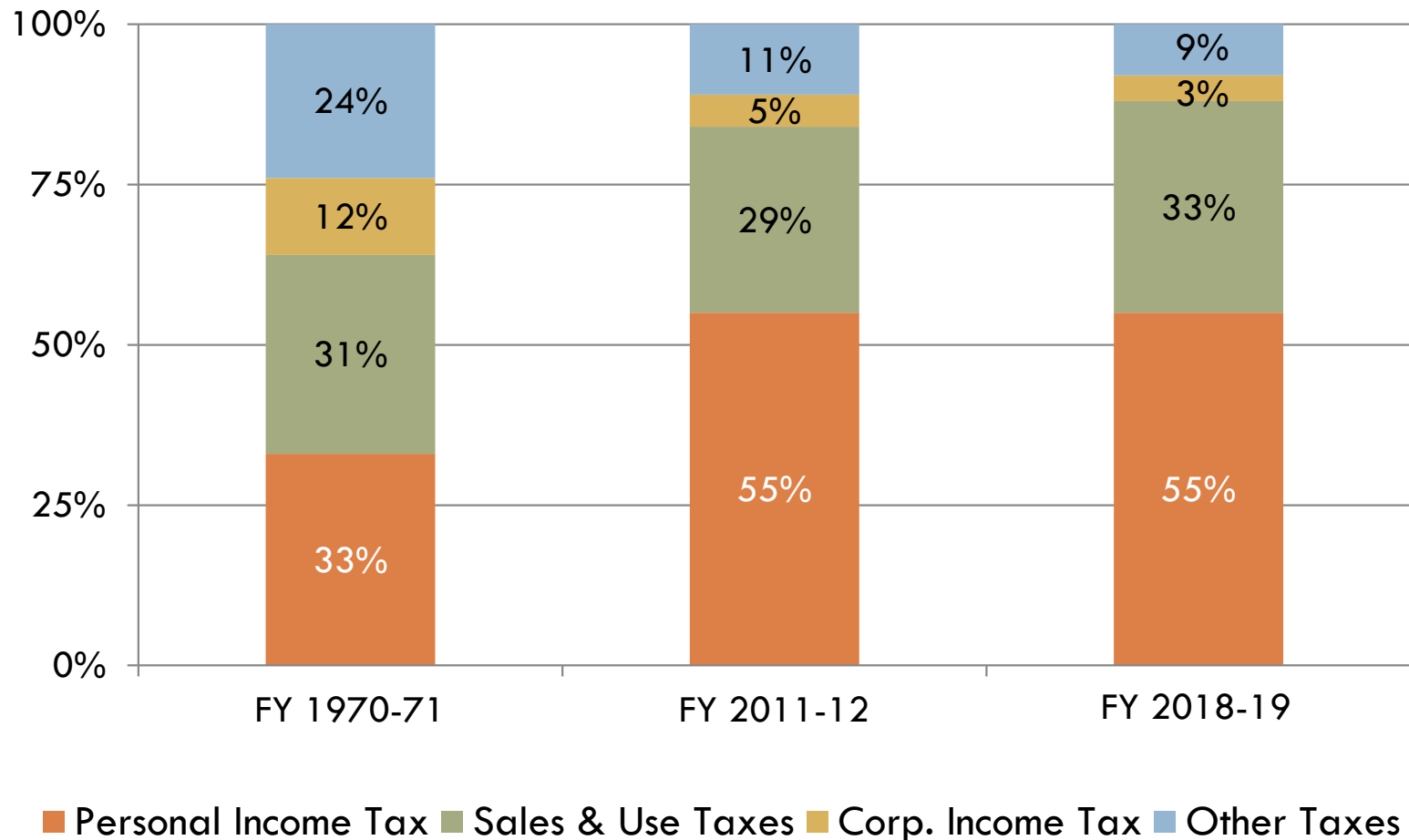
Estimated Revenue Changes

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Estimated Cumulative General Fund Revenue Changes 2011- 2018 Session (\$ millions)

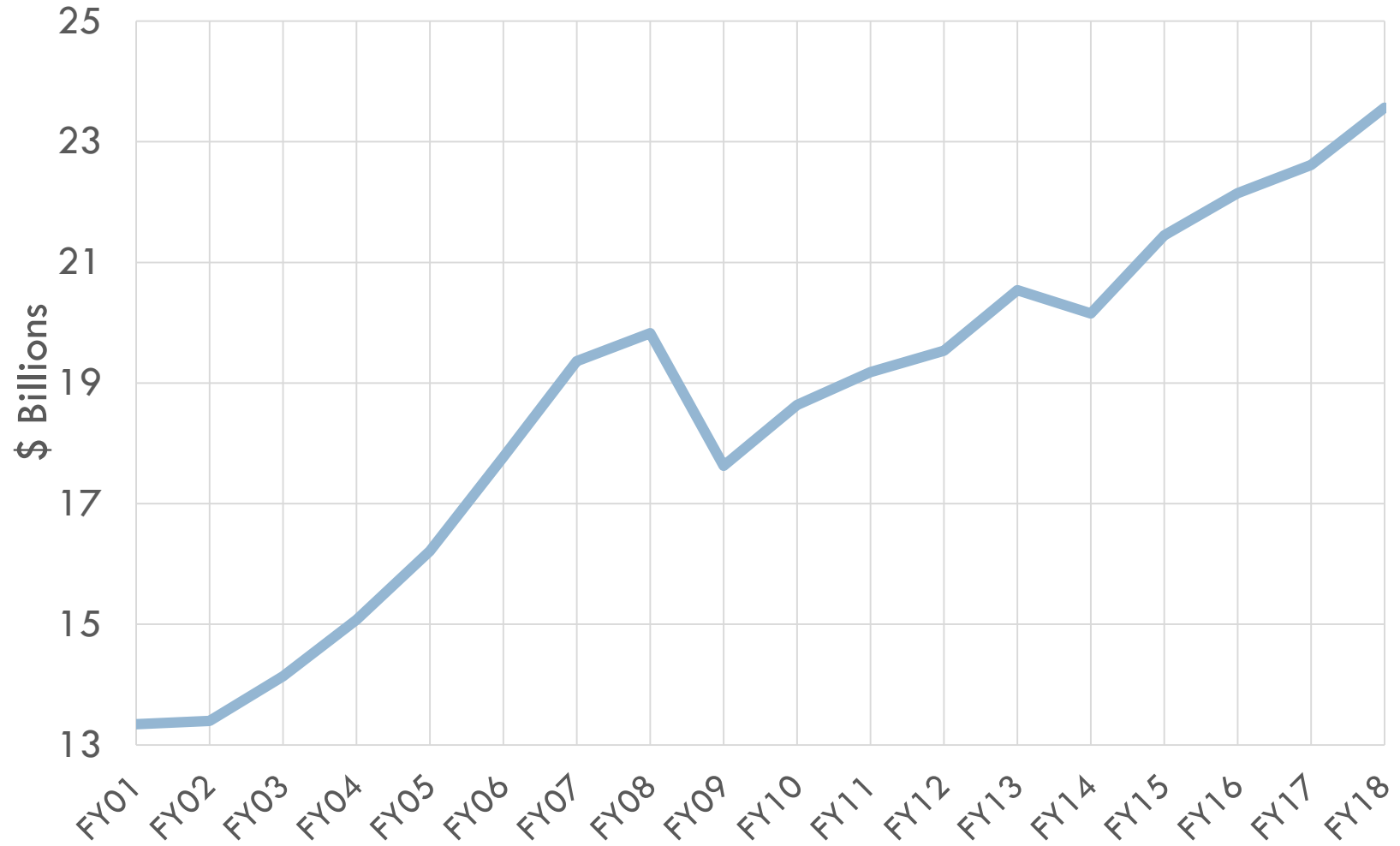
	FY 2018-19	FY 2019-20
Personal Income Tax	(2,167)	(2,693)
Sales and Use Tax	928	956
Corporate Income Tax	(1,115)	(1,180)
Other Tax, Non-Tax, and Transfers	(314)	(319)
Total Fiscal Impact	(2,668)	(3,236)

North Carolina's Changing Tax Structure



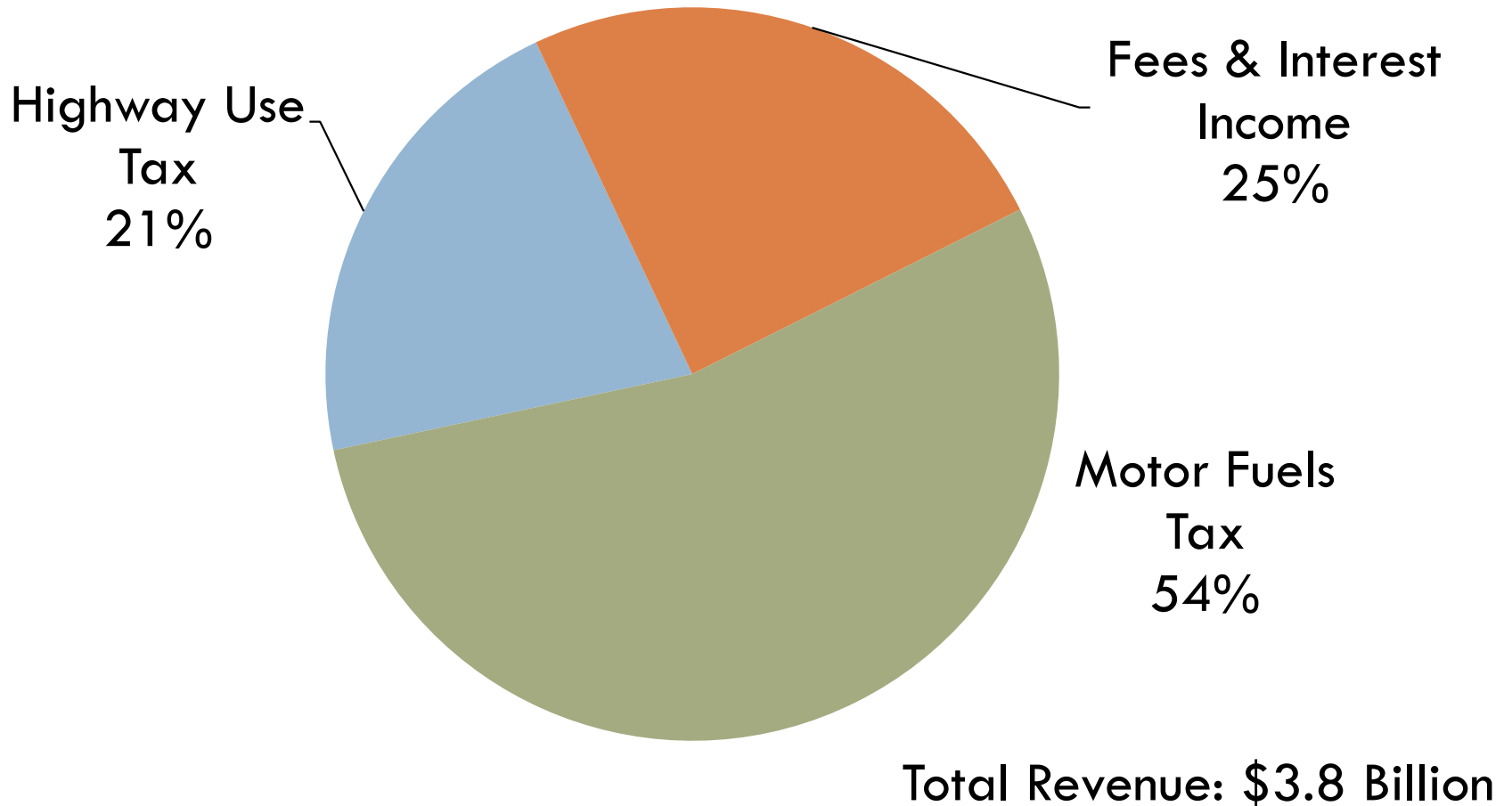
Source: North Carolina General Assembly Fiscal Research Division

General Fund Revenue



Non-General Fund Revenue by Source

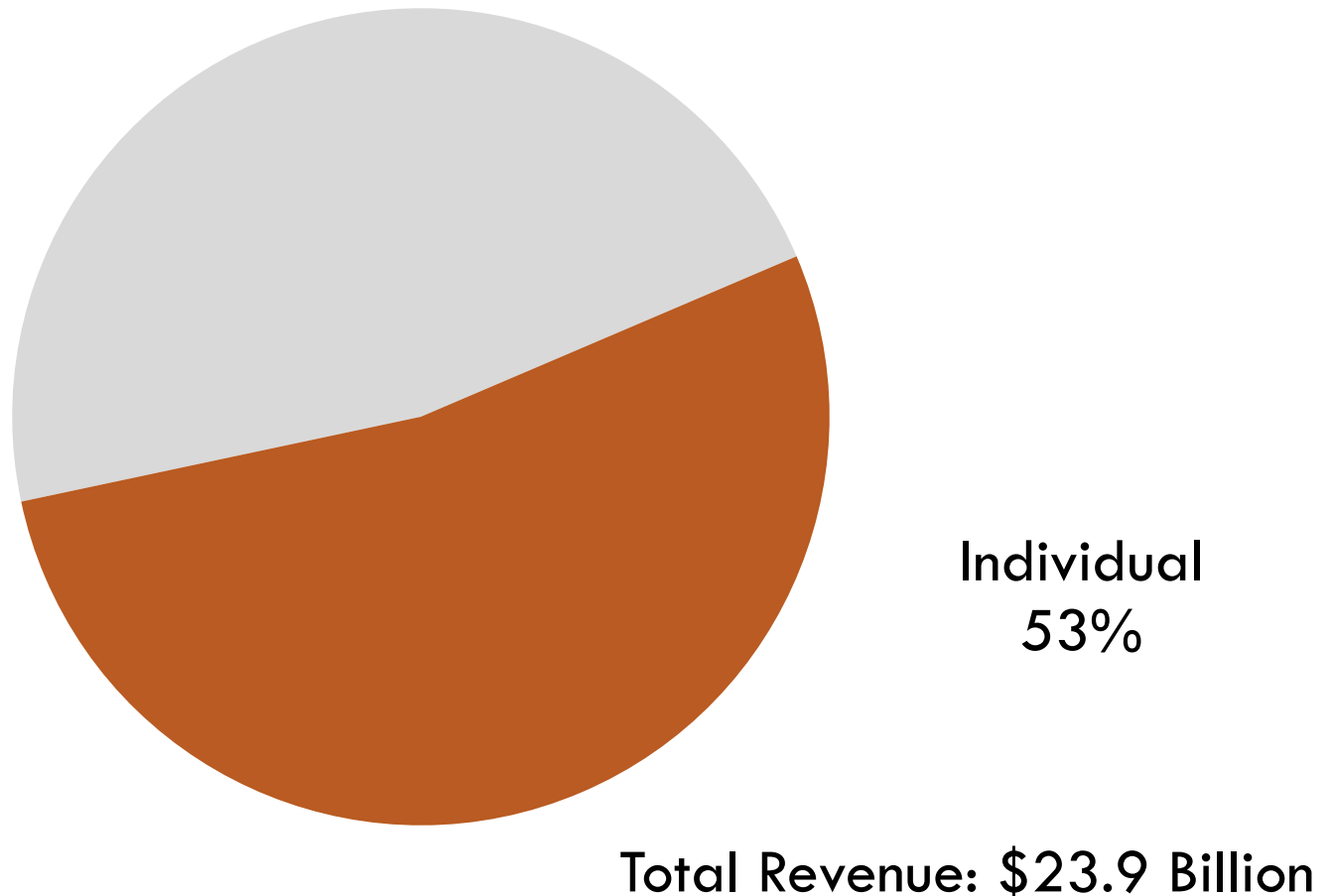
FY 2018-19



PERSONAL INCOME TAX

Greg Roney
Legislative Analysis Division

General Fund Revenue Source: Individual Income Tax, FY 2018-19



Tax Calculation

Personal Income Tax

- Individuals pay each calendar year
 - ▣ Tax Rate: 5.499% Flat Rate
 - ▣ Tax Base: Federal AGI (Pickup)
 - ▣ Tax Calculation
 - Standard (MFJ \$17,500) v. Itemized Deductions (Interest, Property Tax, Charitable, Medical)
 - NC Modifications
 - ▣ Tax “Expenditures”

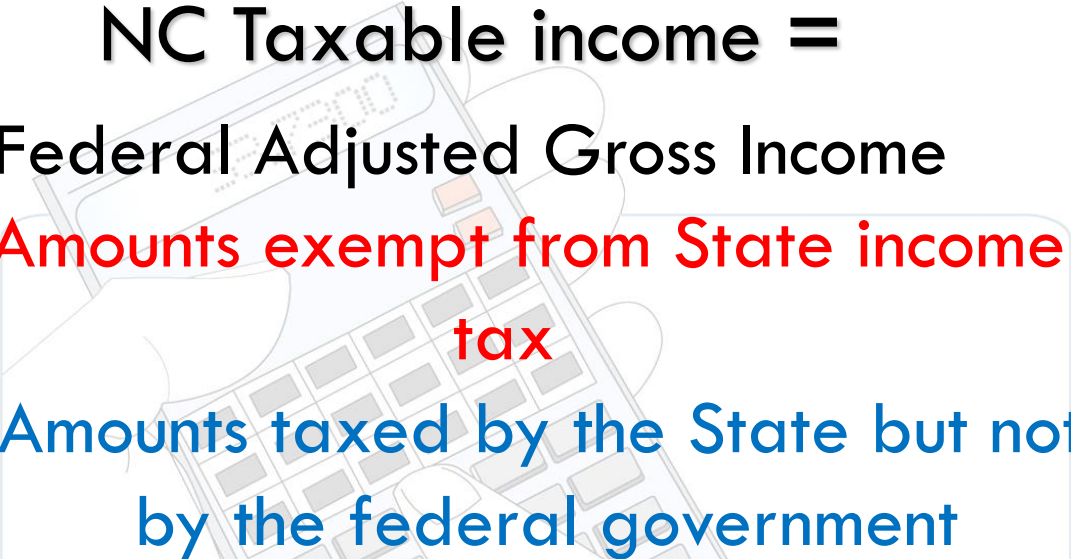
Tax Rate Changes

- 2013: 6% to 7.75%
- 2014: **Flat Rate 5.8%**
- 2015 & 2016: 5.75%
- 2017 & 2018: 5.499%
- 2019: 5.25%



Tax Base

Federal
taxable
income

$$\begin{aligned} \text{NC Taxable income} = & \\ & \text{Federal Adjusted Gross Income} \\ & - \text{Amounts exempt from State income tax} \\ & + \text{Amounts taxed by the State but not} \\ & \quad \text{by the federal government} \end{aligned}$$


Internal Revenue Code Update (IRC Update)

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- ❑ NC law references the federal Internal Revenue Code (IRC) to determine adjusted gross income (AGI) by referencing a version of the IRC by date.
- ❑ Annual IRC update legislation allows the General Assembly to review federal legislation to determine if NC law will conform or decouple from federal law changes.
- ❑ No significant federal tax legislation has been enacted this year requiring legislative decisions to conform or decouple.
- ❑ NC law currently references the IRC enacted as of 2/9/18.
- ❑ IRC update legislation would change reference date to 1/1/19.

State Tax Exemptions

- SSI Benefits
- Interest on US obligations
- Income from an Indian tribe
- Interest on NC and local government obligations
- Interest on obligations of a nonprofit educational institution chartered in NC
- Government retirement income received by employees vested in retirement system by August 12, 1989 (Bailey)

Standard v. Itemized Deduction

□ Standard Deduction

▣ 2018

- MFJ: \$17,500
- HH: \$14,000
- Single: \$8,750
- Filing separate: \$8,750

▣ 2019

- MFJ: \$20,000
- HH: \$15,000
- Single: \$10,000
- Filing separate: \$10,000

□ Itemized Deduction

▣ Charitable Contributions

- Federal rules apply

▣ Medical and Dental Expenses

- Federal rules apply
- 7.5% floor in 2018

▣ Capped at \$20,000

- Home mortgage interest
- Property taxes paid on real estate

Child Deduction

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- Additional NC deduction for children if:
 - ▣ Meet federal rules for child tax credit
 - ▣ Allowed for each child
 - ▣ Maximum value: \$2,500 per child
 - ▣ Completely phased out at
 - MFJ: \$120,000
 - HH: \$90,000
 - Single: \$60,000
 - Married, separate: \$60,000

Tax “Expenditures”

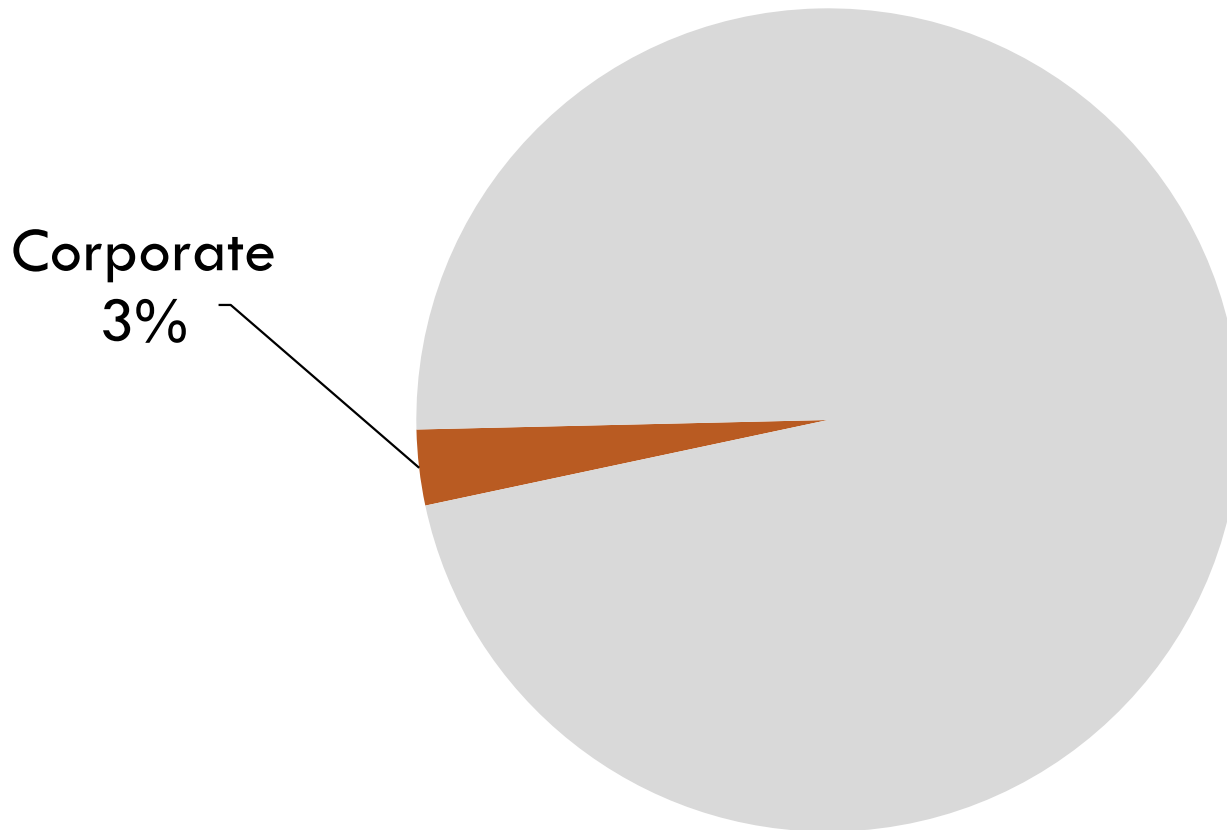
NCDOR FY18-19 Estimate (\$ millions)

- Standard Deduction
\$1,359.1M
- SSI in Excess of
Federal Limit \$486.0M
- Charitable Deduction
\$253.4M
- Child Deduction
\$155.6M
- Mortgage Interest
Deduction \$100.2M
- Medical Deduction
\$65.0M
- Property Tax
Deduction \$61.6M
- Bailey Retirees
\$307.7M (required by
court order)

CORPORATE INCOME TAX

Jonathan Tart
Fiscal Research Division

General Fund Revenue Source: Corporate Income Tax, FY 2018-19



Total Revenue: \$23.9 Billion

Corporate Income Tax

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- Accounts for about 3% of revenue
- About 80,000 returns filed, but 2/3 don't pay tax
- 2/3 of corporate income tax collections come from about 300 to 400 large companies.
- Corporations with NC taxable income of over \$1 million pay about 90% of the total corporate income tax revenue, but they make up less than 3% of the corporations filing returns.

Tax Reform and Corporate Income Tax Rate Changes

- 6.9%
 - ▣ 2013 tax rate
- 6%
 - ▣ 2014 tax rate
- 5%
 - ▣ 2015 tax rate
- 4%
 - ▣ 2016 tax rate
- 3%
 - ▣ 2017 and 2018 tax rate
- 2.5%
 - ▣ 2019 tax rate



Business Tax Base: Before and After Reform

Tax Base Before

Local privilege license taxes

Privilege tax on banks

Credits & Deductions Available

Tax credits for ports charges, recycling oyster shells, renewable fuels, work opportunity, interactive digital media, Article 3J, qualified business venture, film, renewable energy, historic and mill rehabilitation, low income housing, research & development, construction of dwelling units for handicapped, real property donations, conservation tillage equipment, gleaned crops, and construction of poultry composting facility,

Deductions for amortization in excess of depreciation allowed under the Code on the cost of sewage or waste treatment plant, air cleaning devices, recycling facilities, emergency facilities acquired before 1955, reforestation and cultivation of commercially grown trees; eligible income of an international banking facility, tobacco marketing assessments, settlement agreements, hurricane assistance, interest earned on deposits by a savings and loan association

Tax Base After

Credits & Deductions Available

Historic rehabilitation, miscellaneous others that are administrative in nature

Computing NC Taxable Income

- Start with federal taxable income
- Adjust for differences in federal and state law (similar to personal income tax, IRC Update)
- Apply apportionment % if corporation is multi-state
- Apply 2.5% tax rate.

Tax Reform and Apportionment

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- When a corporation operates in multiple states, a state can only tax a percentage of the income.
- Example: Ollie Manufacturing, Inc. does business in 20 states and has \$40 million in income. Absent an apportionment requirement, Ollie's \$40 million could be taxed 20 times.
- States have some policy discretion regarding the apportionment method used. Before tax reform, NC used a method that considered the share of Ollie's employees and operations located in NC.

NC Apportionment Formula Change

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Starting in 2018, NC uses sales/revenue factor apportionment. This provides an economic incentive for manufacturing companies like Ollie the manufacturer to expand and create jobs in NC. Example: Assume Ollie Mfg. operates in 20 states and has \$40M in income. 60% of Ollie's employees and capital investment are in NC. 10% of Ollie's goods are sold to NC consumers. The rest are sold to customers outside the state.

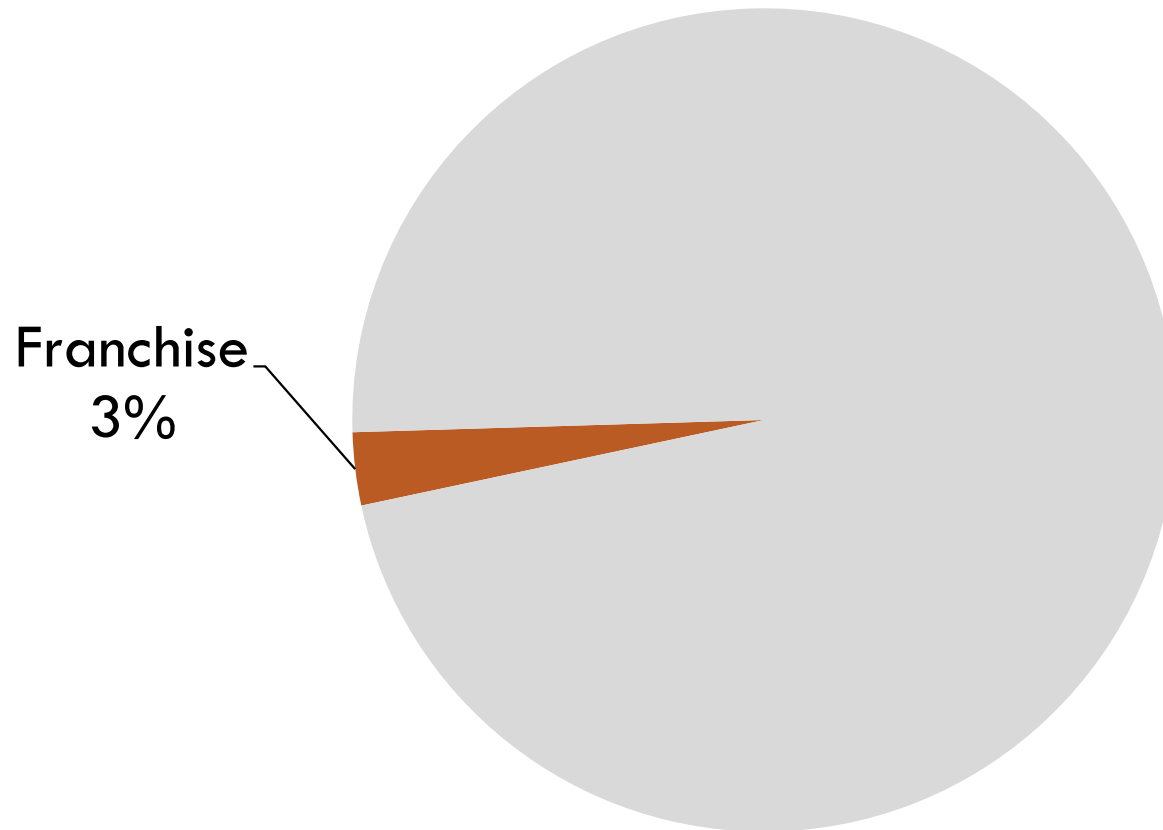
Income before apportionment:	\$40M
Income apportioned to NC:	10%
Income taxed in NC:	\$4M

Only 10% of Ollie's income is taxed by NC even though 60% of operations and employees are located in NC. However, if Ollie is a service provider, the apportionment is not done the same way. A change to treat Ollie the service provider the same as Ollie the manufacturer was studied as part of tax reform but not enacted.

FRANCHISE TAX

Jonathan Tart
Fiscal Research Division

General Fund Revenue Source: Franchise Tax, 2018-19



Total Revenue: \$23.9 Billion

Franchise Tax



- Accounts for about 3% of revenue
- Tax imposed for:
 - ▣ The privilege of engaging in business
 - ▣ The benefit and protection received from the government and laws of NC in doing business

Who pays Franchise Tax?

- C corporations (about 80,000)
- S corporations (about 160,000)
- Limited liability companies (LLC), partnerships, sole proprietorships are exempt from tax
 - An LLC pays \$200 annual report filing fee in lieu of Franchise Tax

Franchise Tax Base

Tax rate is generally .15% (\$1.50 per \$1,000). The rate is applied to the highest of three alternate bases:

- Net Worth apportioned to NC using the apportionment percentage determined for income tax
- Book value of NC real and tangible personal property, less outstanding debt created to acquire or improve the real property
- 55% of the appraised value of NC real and tangible personal property

Franchise Tax Reform

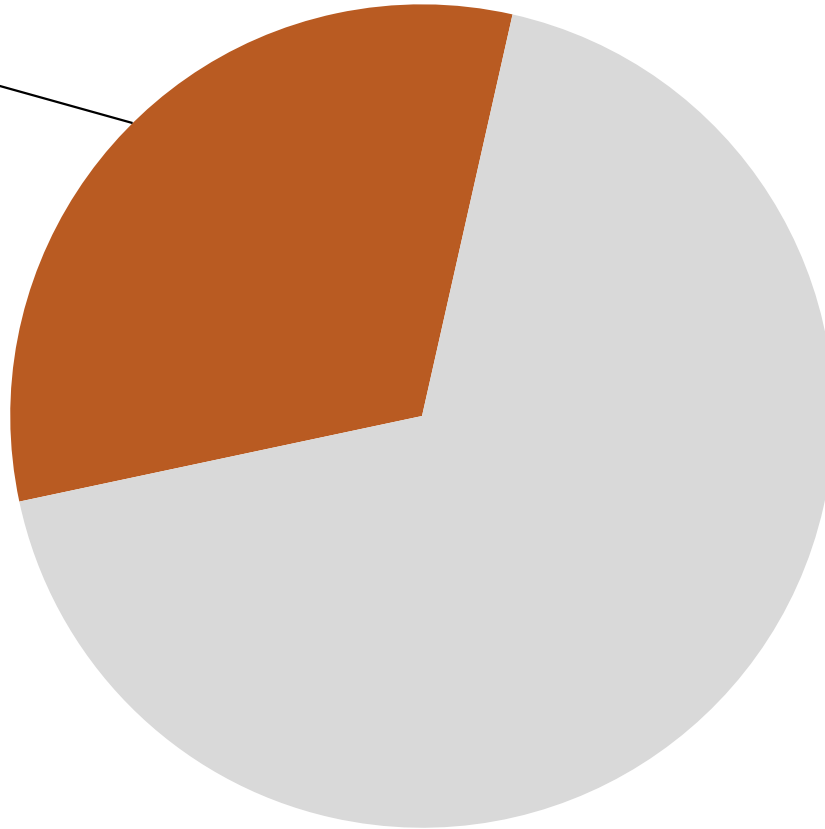
- Simplified calculation to tie more closely to net worth as determined for accounting purposes
- Increased minimum tax from \$35 to \$200
- Increased maximum tax on holding companies from \$75,000 to \$150,000
- Reduced tax rate for S corporations to a maximum of \$200 on the first \$1 M.

SALES TAX

Trina Griffin
Legislative Analysis Division

General Fund Revenue Source: Sales and Use Taxes, FY 2018-19

Sales and Use
32%



Total Revenue: \$23.9 Billion

Rates

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- State General rate is 4.75%
 - ▣ Items that are subject to State sales and use tax are also subject to the local sales and use tax. Local rates vary.
- Preferential Rates
 - ▣ Boats, 3% with \$1,500 cap
 - ▣ Aircraft, general rate capped at \$2,500
 - ▣ Modular and manufactured homes, jet engines – not subject to local sales tax
- Combined General Rate – 7%
 - ▣ Spirituous Liquor
 - ▣ Telecommunications
 - ▣ Video Programming
 - ▣ Electricity & Piped Natural Gas
 - ▣ Aviation Gasoline & Jet Fuel

Base

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- Tangible personal property
 - ▣ No State sales tax on groceries
- Digital property
- Some services
 - ▣ Electricity & piped natural gas
 - ▣ Telecommunications
 - ▣ Video Programming
 - ▣ Repair, Maintenance, and Installation Services
- Accommodations
- Entertainment Activity/Admission Charges
- Service Contracts



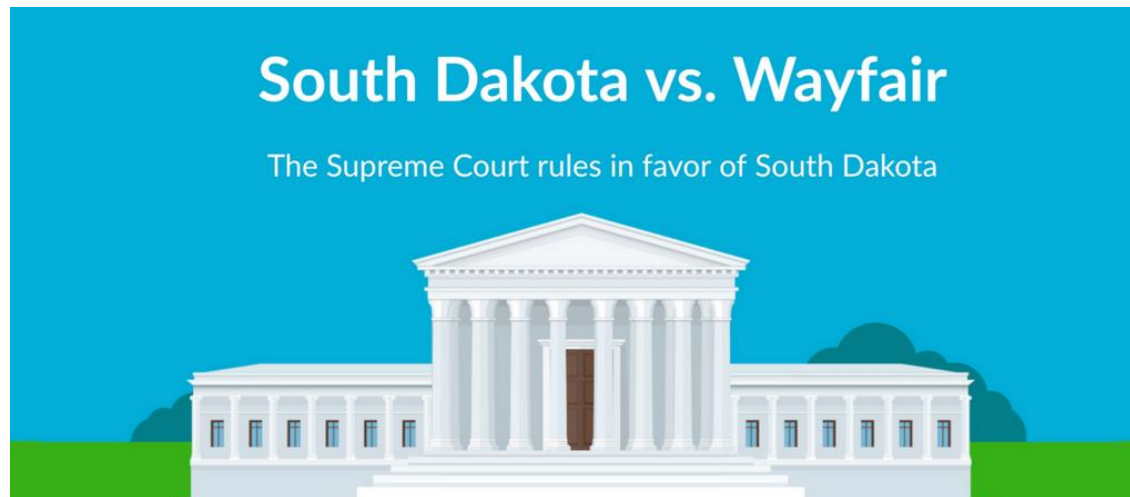
Wayfair

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- Economic nexus
 - ▣ >\$100,000 or
 - ▣ >200 transactions
- NC DOR Directive,
issued Aug. 7, 2018



- Physical presence



Local Sales Tax Rates and Distributions

Article	Rate	Purpose	Distribution	Levied By
1 st 1 cent Art. 39		Any lawful purpose	Point of collection; shared with cities	100 counties
1 st ½ cent Art. 40		70% - general 30% - school capital	Per capita; shared with cities	100 counties
2 nd ½ cent Art. 42		40% - general 60% - school capital	Point of collection; shared with cities	100 counties
¼ cent Art. 46		Any lawful purpose	Point of collection – <i>distributed to county only.</i>	42 counties
½ cent or ¼ cent Art. 43	 or 	Public transportation	Per capita - Among county and cities in county that operate a public transportation system	4 counties

Sales Tax Rates Across the Counties

Counties	State	+	Local	=	Total
<u>67 Counties:</u> Alamance; Alleghany; Avery; Beaufort; Bertie; Bladen; Brunswick; Burke; Caldwell; Camden; Carteret; Caswell; Chatham; Chowan; Clay; Cleveland; Columbus; Craven; Currituck; Dare; Davie; Forsyth; Franklin; Gaston; Gates; Graham; Granville; Guilford; Henderson; Hoke; Hyde; Iredell; Johnston; Jones; Lenoir; Lincoln; Macon; Madison; McDowell; Mitchell; Moore; Nash; Northampton; Pamlico; Pasquotank; Pender Perquimans; Person; Polk; Richmond; Rockingham; Rutherford; Scotland; Stanly; Stokes; Swain; Transylvania; Tyrrell ; Union; Vance; Warren; Washington; Watauga; Wayne; Wilson; Yadkin; Yancey.	4.75%	+	2.0%	=	6.75%
<u>29 Counties:</u> Alexander; Anson; Ashe; Buncombe; Cabarrus; Catawba; Cherokee; Cumberland; Davidson; Duplin; Edgecombe; Greene; Halifax; Harnett; Haywood; Hertford; Jackson; Lee; Martin Montgomery; New Hanover; Onslow; Pitt; Randolph; Robeson; Rowan; Sampson; Surry; Wilkes.	4.75%	+	2.25%	=	7.0%
<u>2 Counties:</u> Mecklenburg; Wake as of 4/1/17.	4.75%	+	2.5%	=	7.25%
<u>2 Counties:</u> Durham; Orange.	4.75%	+	2.75%	=	7.50%

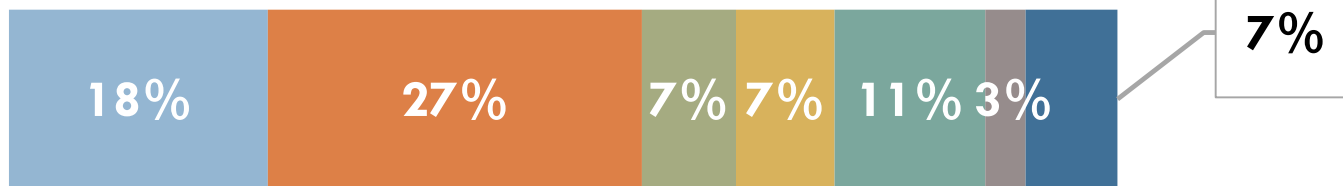
LOCAL REVENUES

Rodney Bizzell
Legislative Analysis Division

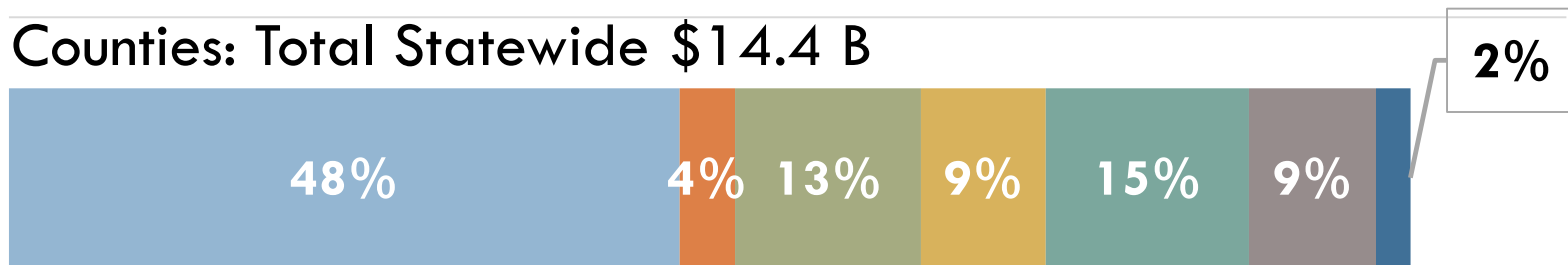
Sources of Local Revenue, FY 2016-17

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Municipalities: Total Statewide \$11.4 B



Counties: Total Statewide \$14.4 B



- Property Taxes
- Sales Tax
- Intergovernmental
- Other Miscellaneous
- Utilities (Municipals) / Other Taxes (Counties)
- Sales & Services
- Debt Proceeds

Source: Dept. of State Treasurer

Local Taxes: Property Tax

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- ❑ Authorized as local revenue source in 1921.
- ❑ Most stable local revenue source.
- ❑ Real property must be revalued at least every 8 years.
- ❑ Classes of property must be taxed uniformly.
- ❑ Only the General Assembly has authority to exempt classes of property.
- ❑ Each county or municipality determines the property tax rate annually

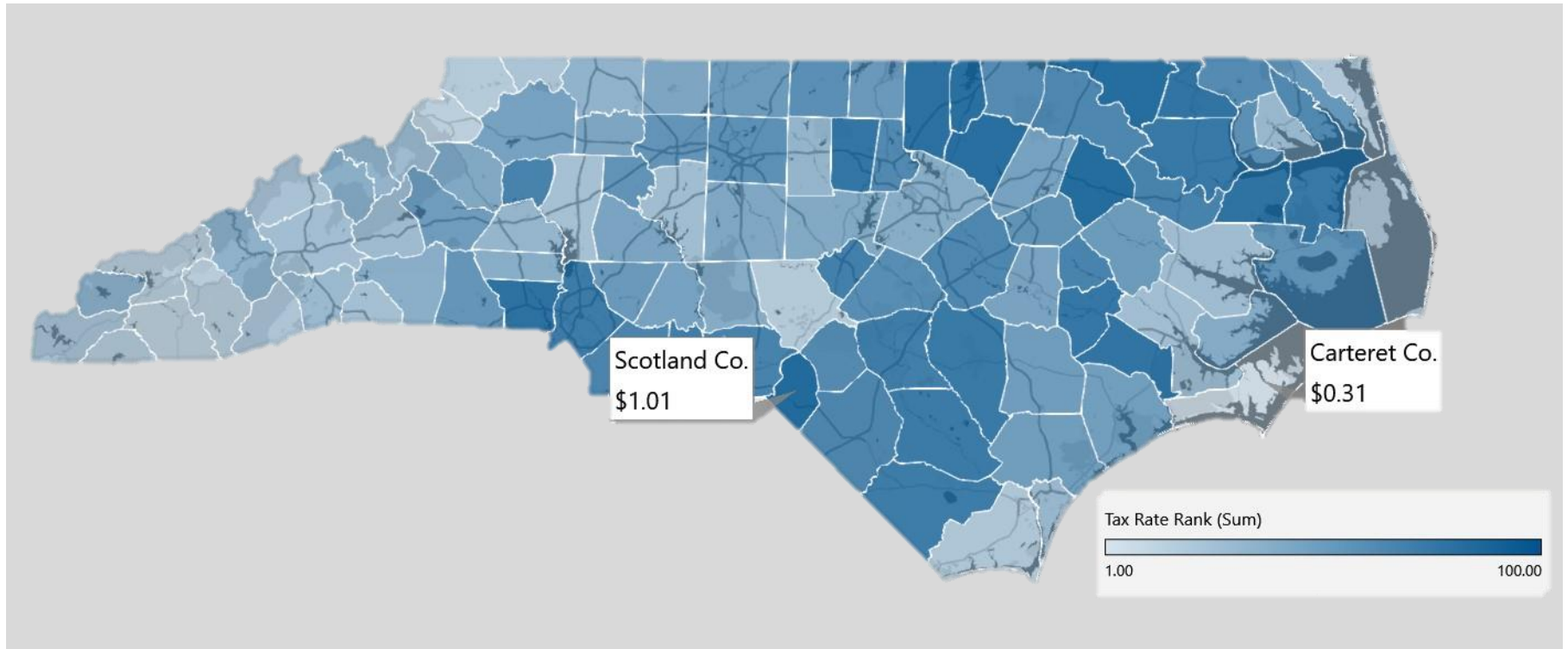
Property Tax Rates

49

- Average: .63 (counties), .45 (*municipalities*)
- Highest: 1.01 (Scotland)
- Lowest: .31 (Carteret)
- *Lowest rates in mountain and coastal counties.*

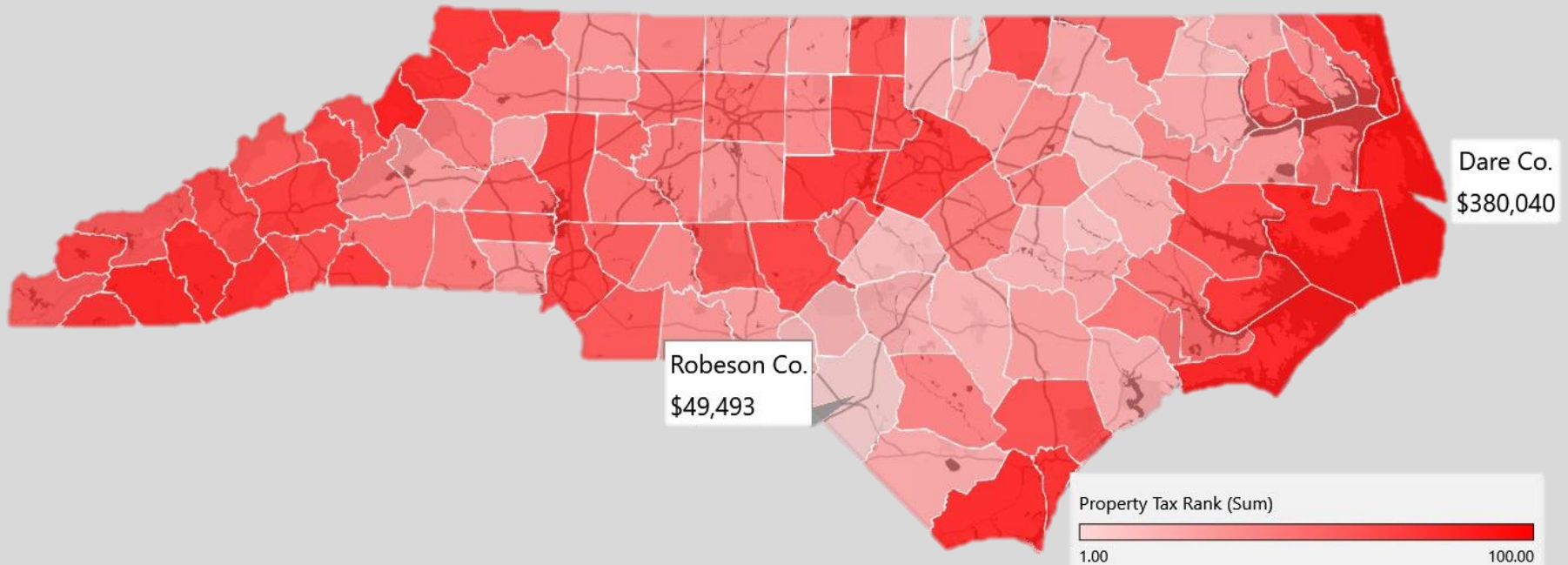
Property Tax Rates

50



Property Tax Base per Capita

51



Revenues Authorized by Local Act

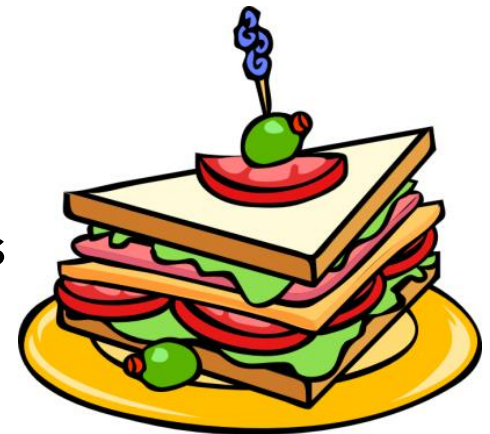
52

□ Occupancy Taxes

- ▣ Levied on occupancy of rental accommodations
- ▣ Taxes typically range from 3%-6%
- ▣ House Finance guidelines require at least two-thirds of expenditures to be used for promotion of travel and tourism
- ▣ The remainder can be used for tourism-related expenses

□ Meals Taxes

- ▣ Typically 1%
- ▣ Levied on prepared food and beverages



QUESTIONS?